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GROWING COMPANIES

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THE ANTI-MARKETERS
How Patagonia Has Become the Hottest Mail-Order Business Around: Page 62

THE FASTEST-GROWING CITIES IN AMERICA

INC.'s ANNUAL RANKING OF THE METROPOLITAN ECONOMIES: PAGE 74

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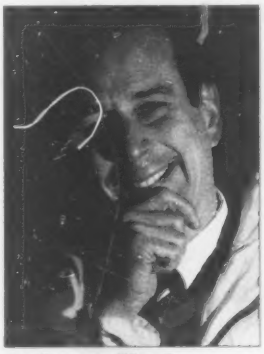

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Nigel Holmes

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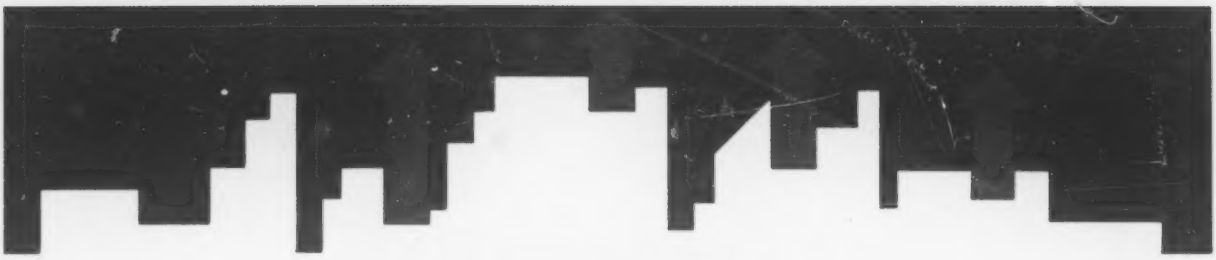


METRO REPORT

HOT SPOTS

INC.'s annual ranking of America's cities

IT WAS THE BIG CONTEST THIS SEASON IN THE ONGOING economic-development sweepstakes. The prize: Sematech, the nation's most advanced computer-chip research facility, operated by a consortium of 14 of the nation's leading chip manufacturers. The stakes: 800 mostly high-paying jobs, the potential for dozens of high-technology spin-offs, and a $250-million annual operating budget. The contestants: 34 states representing more than 100 local communities. The winner: Austin.

METRO LEADERS	
Company Start-ups	Austin
Job Growth	Orlando
Fast-Growth Companies	Manchester-Nashua, N.H.

Austin these days has as much going for it as an armadillo in a cactus patch. A state capital. A world-class university. The nation's top microcomputer research facility. Culture. Beauty. And plenty of affordable housing. It all adds up to a penchant for starting and growing companies that puts it on top of INC.'s annual metropolitan ranking for the second year in a row.

Austin today is not quite the boomtown it was before the price of oil dropped and a shakeout rocked Texas high tech—and before overdevelopment put Austin real estate into its current slump. But in spite of these challenges—or as David L. Birch points out on page 80, maybe because of them—Austin has posted a four-year record of economic growth that is still unmatched anywhere in the country.

Not all of urban Texas has fared so well. The cities taken down more than 30 places this year on the INC. metropolitan rankings read like an oil-field Baedeker: Tyler, Amarillo, Houston, Odessa-Midland, and Waco, Tex., with nearby Baton Rouge and Lafayette, La., thrown in for good measure. All of which makes it more impressive still that, in terms of business birthrates, the three top cities in the country are Austin, El Paso, and Dallas-Fort Worth.

Business birthrate is one of the three historical criteria used in the annual INC. metro rankings. The other two are the percentage growth in private employment and the percentage of young companies experiencing high growth. For each city, a relative score for each factor was calculated based on a four-year period, then the three numbers were added together for an overall score. A complete list of the metropolitan areas with this year's and last year's rankings appears on the opposite page.

The 1988 metro rankings show a healthier urban economy than a year ago in all three categories, with a median birthrate of 2.7% and 2.9% of small, young companies experiencing rapid growth. The median percentage of job growth over a four-year period was 15%.

Aside from the oil-patch metropolises, the big losers over the past year include Syracuse, N.Y., New London, Conn., and the small Georgia cities of Columbus and Augusta. Wisconsin's Madison and Green Bay both dropped more than 30 places, even as Milwaukee made gains. Melbourne-Titusville, Fla., heavily dependent on the nation's space-shuttle program, slipped badly, although Huntsville, Ala., headquarters of NASA's George C. Marshall Space Flight Center, climbed from #10 to #7. Colorado Springs, Colo., feeling the shakeout in the oil, mining, and computer industries, dropped from #27 to #63.

Last October, in our annual Report on the States, INC. lavished high praise on the economic-development initiatives of Pennsylvania and Michigan, and this year's Metro Report confirms that positive assessment. Moving up dramatically in the rankings this year were the Michigan cities of Lansing, Flint, and Saginaw-Bay City along with Pennsylvania's Lancaster, York, Harrisburg, Philadelphia, and Johnstown-Altoona. To be sure, none of these industrial outposts has made it yet into the top tier of growing cities, but their movement upward is the latest proof that a Rustbelt revival is underway. So, too, is the continued presence of South Bend and Fort Wayne among the top 50 cities, with the addition this year of Indianapolis, moving up impressively from #71 to #35. Noticeably left out of this positive trend is industrial Illinois, which continues to claim no city in the top half of this

ILLUSTRATION: NIGEL HOLMES

METRO RANKING

1988 Rank / Area / 1987 Rank

1. Austin, TX (1)
2. Manchester-Nashua, NH (8)
3. Orlando, FL (2)
4. Phoenix, AZ (3)
5. Atlanta, GA (9)
6. Raleigh-Durham, NC (7)
7. Huntsville, AL (10)
8. Washington, DC (11)
9. Dallas-Fort Worth, TX (4)
10. San Diego, CA (13)
11. Nashville, TN (15)
12. Tucson, AZ (5)
13. Portsmouth-Dover, NH (20)
14. Albuquerque, NM (12)
15. Tampa-St. Petersburg, FL (23)
16. Pensacola, FL (31)
17. Fort Myers, FL (22)
18. South Bend, IN (24)
19. Charleston, SC (14)
20. Norfolk-Portsmouth, VA (21)
21. San Antonio, TX (6)
22. Jacksonville, FL (16)
23. Boston, MA (25)
24. Baltimore, MD (43)
25. Richmond, VA (58)
26. El Paso, TX (19)
27. Las Vegas, NV (47)
28. Greensboro, NC (60)
29. Sarasota, FL (28)
30. Memphis, TN (26)
31. Columbus, OH (40)
32. Charlotte, NC (66)
33. Los Angeles, CA (37)
34. Minneapolis-St. Paul, MN (49)
35. Indianapolis, IN (71)
36. Wilmington, DE (32)
37. Portland, ME (76)
38. Fort Wayne, IN (34)
39. Fayetteville, AR (68)
40. Seattle, WA (65)
41. Miami-Fort Lauderdale, FL (52)
42. Tallahassee, FL (18)
43. Santa Barbara, CA (42)
44. San Francisco, CA (35)
45. Columbia, SC (38)
46. Sacramento, CA (33)
47. Lexington, KY (56)
48. Melbourne-Titusville, FL (17)
49. Philadelphia, PA (69)
50. Detroit, MI (50)
51. Grand Rapids, MI (54)
52. Denver-Boulder, CO (29)
53. Savannah, GA (39)
54. Kansas City, MO (44)
55. Worcester, MA (51)
56. Salt Lake City, UT (36)
57. Lancaster, PA (82)
58. Bridgeport-Stamford, CT (46)
59. Daytona Beach, FL (62)
60. Macon, GA (115)
61. Cincinnati, OH (77)
62. Augusta, GA (30)
63. Colorado Springs, CO (27)
64. Birmingham, AL (85)
65. Knoxville, TN (86)
66. Albany, NY (78)
67. Lansing, MI (132)
68. New Haven, CT (87)
69. Lincoln, NE (57)
70. Jackson, MS (99)
71. Dayton, OH (105)
72. Little Rock, AR (70)
73. Reno, NV (91)
74. Greenville, SC (92)
75. Toledo, OH (80)
76. Omaha, NE (84)
77. Santa Cruz, CA (61)
78. Topeka, KS (103)
79. New York, NY (81)
80. Stockton-Modesto, CA (83)
81. Montgomery, AL (53)
82. Madison, WI (48)
83. Honolulu, HI (NA)*
84. St. Louis, MO (90)
85. Boise, ID (64)
86. Flint, MI (136)
87. Portland, OR (96)
88. Baton Rouge, LA (45)
89. Saginaw-Bay City, MI (142)
90. Rochester, NY (73)
91. New London, CT (55)
92. Houston, TX (41)
93. Springfield, MO (59)
94. New Bedford, MA (67)
95. Chicago, IL (106)
96. Hartford, CT (110)
97. Roanoke, VA (101)
98. Rockford, IL (94)
99. Waco, TX (63)
100. Louisville, KY (93)
101. Monterey, CA (114)
102. Wichita, KS (111)
103. Providence, RI (NA)*
104. York, PA (127)
105. Chattanooga, TN (100)
106. Cleveland-Akron, OH (118)
107. Spokane, WA (113)
108. Lakeland, FL (88)
109. Milwaukee, WI (124)
110. Battle Creek, MI (107)
111. Green Bay, WI (72)
112. Syracuse, NY (79)
113. Harrisburg, PA (133)
114. Mobile, AL (120)
115. Binghamton, NY (126)
116. Springfield, MA (116)
117. Cedar Rapids, IA (145)
118. Atlantic City, NJ (97)
119. Champaign, IL (131)
120. Fresno, CA (134)
121. Eugene, OR (137)
122. Pittsfield, MA (117)
123. Bakersfield, CA (104)
124. Youngstown, OH (139)
125. Tacoma, WA (130)
126. Johnstown-Altoona, PA (146)
127. Buffalo, NY (123)
128. Evansville, IN (109)
129. Corpus Christi, TX (98)
130. Des Moines, IA (122)
131. Pittsburgh, PA (141)
132. Brownsville, TX (102)
133. Tulsa, OK (108)
134. Allentown, PA (135)
135. Scranton, PA (140)
136. Tyler, TX (74)
137. New Orleans, LA (129)
138. Erie, PA (143)
139. Shreveport, LA (128)
140. Columbus, GA (75)
141. Johnson City, TN (148)
142. Beaumont, TX (147)
143. Amarillo, TX (89)
144. Lubbock, TX (112)
145. Utica-Rome, NY (138)
146. Springfield, IL (149)
147. Charleston, WV (150)
148. Huntington, WV (152)
149. Reading, PA (144)
150. Davenport, IA (151)
151. Oklahoma City, OK (125)
152. Canton, OH (121)
153. Peoria, IL (153)
154. Duluth, MN (154)
155. Lafayette, LA (95)
156. Odessa-Midland, TX (119)

*NA: no answer

LANSING, MICHIGAN
An aggressive state-development program and a restructuring of the American auto industry helped make this the 'most improved' metro area.

CHARLOTTE, NORTH CAROLINA
Bank deregulation has helped make this quiet outpost into a financial center for the entire Southeast region.

HOUSTON, TEXAS
The cities slipping badly on this year's ranking read like an oil-field Baedeker, including this world capital of Big Oil, which dropped 50 places.

PHOTOGRAPHS: TOP, DENNIS COX; CENTER, STEVE MURRAY, PICTURESQUE; BOTTOM, STOCKPHOTOS, SAM ZAREMBER

METRO RANKING/THE TOP 25

Rank/Area	Growth In Jobs	Business Birthrate	% of Fast-Growing Companies
1. Austin, TX	42.9%	6.8%	4.0%
2. Manchester-Nashua, NH	38.9	4.0	5.9
3. Orlando, FL	53.5	4.9	4.0
4. Phoenix, AZ	40.4	5.0	4.2
5. Atlanta, GA	36.3	4.6	4.2
6. Raleigh-Durham, NC	31.2	4.6	4.5
7. Huntsville, AL	41.9	4.3	3.8
8. Washington, DC	32.3	4.2	4.4
9. Dallas-Fort Worth, TX	23.5	5.3	3.9
10. San Diego, CA	26.8	4.1	4.3
11. Nashville, TN	25.2	4.2	4.2
12. Tucson, AZ	27.1	4.3	3.7
13. Portsmouth-Dover, NH	29.3	3.3	4.2
14. Albuquerque, NM	23.4	3.7	4.1
15. Tampa-St.Petersburg, FL	28.8	3.9	3.4
16. Pensacola, FL	26.2	3.5	3.8
17. Fort Myers, FL	44.7	3.9	2.3
18. South Bend, IN	22.1	3.4	4.1
19. Charleston, SC	24.7	4.1	3.2
20. Norfolk-Portsmouth, VA	27.4	3.7	3.4
21. San Antonio, TX	15.2	4.2	3.6
22. Jacksonville, FL	26.1	3.6	3.4
23. Boston, MA	17.5	2.8	4.6
24. Baltimore, MD	17.8	3.4	3.9
25. Richmond, VA	17.7	3.1	4.1

Among the hottest cities, overall growth in employment is linked directly to a healthy number of young, fast-growing companies . . .

METRO RANKING/THE BOTTOM 25

Rank/Area	Growth In Jobs	Business Birthrate	% of Fast-Growing Companies
132. Brownsville, TX	0.8%	2.6%	2.0%
133. Tulsa, OK	-4.6	2.8	2.1
134. Allentown, PA	3.4	1.8	2.5
135. Scranton, PA	9.1	1.5	2.4
136. Tyler, TX	-6.1	3.2	1.6
137. New Orleans, LA	-7.5	2.6	2.2
138. Erie, PA	0.0	1.7	2.5
139. Shreveport, LA	-3.9	2.9	1.6
140. Columbus, GA	14.5	2.5	0.8
141. Johnson City, TN	8.3	2.4	1.2
142. Beaumont, TX	-17.1	3.0	2.0
143. Amarillo, TX	1.1	2.6	1.2
144. Lubbock, TX	-3.7	1.9	2.1
145. Utica-Rome, NY	9.5	1.2	1.9
146. Springfield, IL	4.1	1.3	2.1
147. Charleston, WV	-5.8	2.5	1.6
148. Huntington, WV	-5.1	2.7	1.2
149. Reading, PA	5.3	1.6	1.5
150. Davenport, IA	2.5	1.6	1.6
151. Oklahoma City, OK	-11.3	2.6	1.5
152. Canton, OH	2.7	2.2	1.0
153. Peoria, IL	-7.8	1.9	1.8
154. Duluth, MN	-11.4	1.7	2.0
155. Lafayette, LA	-27.0	3.1	1.3
156. Odessa-Midland, TX	-31.1	2.3	1.8

. . . While in many oil and mining towns, staggering declines in overall employment have dampened entrepreneurial activity.

year's metro class. David Moberg's examination of Chicago's distinctly unentrepreneurial economy begins on page 84.

Every city likes to think that its progress is a result of its own hard work, but sometimes the presence of strong cities nearby has a lot to do with it. That may help to explain the great strides made this year by Richmond and Baltimore, and the continued strong performance of Norfolk, Va., which together have begun to define an outer edge for the booming Washington, D.C. (#8) economy. Boston, #23, which long ago started to spin off booming high-tech satellites in Manchester and Portsmouth, N.H., also seems to have added Portland, Maine, to its constellation. Portland has moved up a whopping 39 places this year.

Not all of the comers on this year's list can be so neatly explained. In the Old South, impressive gains were posted by Jackson, Miss.; Birmingham, Ala.; Knoxville, Tenn.; Greensboro, N.C.; and Macon, Ga.—once sleepy cities with rural roots, they now boast an impressive number of their own young, fast-growing firms. In the heartland, Cedar Rapids and Topeka began to pull themselves out of the Farmbelt slump. Dayton stepped confidently out of the bottom third of our list, on the strength of its tradition of aerospace engineering and its Air Force connections. Other cities to watch: Charlotte, N.C. (#32), which has leveraged bank deregulation to build itself into a mighty financial center; and Seattle (#40), making an impressive transition from aerospace manufacturing to a more diverse economy with plenty of new companies in the growth areas of high tech and Pacific Rim trade.

METRO REPORT continues on page 80

HOW THE CITIES WERE RANKED Our annual report on metropolitan areas is based on three objective factors: job generation, rate of significant new business start-ups, and the percentage of young companies enjoying high growth rates. For each factor, each metropolitan area was assigned a score from 1 to 33.33, reflecting its relative standing among cities in the United States. The overall rank of a city was based on the sum of the three scores.

Metropolitan areas were defined as counties or groups of counties closely related by community patterns. In general, a densely settled suburban community was grouped with an urban county if 15% of its residents reported working in the city.

The rate of significant business births was derived by dividing the total number of business enterprises in an area by the number founded since January 1983 that had 10 or more employees by July 1987. The number of high-growth companies was figured as a percentage of all companies founded between January 1979 and January 1983. For each company, an index was calculated by multiplying its absolute growth in employment between January 1983 and July 1987 by its percentage of employment growth during the same period. Companies with an index of 20 or higher were classified as high growth. Employment figures, compiled from data collected by the Bureau of the Census and the Bureau of Labor Statistics, measure the change in private employment between January 1983 and March 1987.

All data were provided by Cognetics Inc., in Cambridge, Mass., and prepared under the direction of special projects editor Sara Baer-Sinnott. For a complete listing of all rankings or for information on reprints, call Judith Comstock at (800) 372-0018.

METRO REPORT

THRIVING ON ADVERSITY

Sometimes entrepreneurship does best when the local economy appears to have taken a turn for the worse

BY DAVID L. BIRCH

IT DOES SEEM A BIT STRANGE. There they are, Austin and Dallas, suffering through a two-year, Texas-size slowdown, right up there among the top 10 on INC.'s ranking of metropolitan areas. And from the Indiana Rustbelt come South Bend and Indianapolis and Fort Wayne, edging out such Sunbelt boomtowns as Miami and Santa Barbara. How is it that INC. is so bullish on cities that everyone knows are laying off, cutting back, and watching the price of real estate drop?

The layoff of some 50,000 aircraft workers started a wave of entrepreneurship.

Actually, it is not as strange as it may look. The explanation is often quite simple: entrepreneurship thrives on adversity. The INC. metropolitan ranking, after all, is *not* a general measure of this year's prosperity. Instead, it attempts to capture the economic yeastiness of a community—the extent to which it has offered a good climate for starting and growing companies over a five-year period. And as the results bear out, sometimes a severe problem in one part of a city's economy—a major plant shutdown or a shakeout in a dominant industry—can actually stimulate the process by which companies are started.

The correlation is not statistically precise, I admit, but from the standpoint of human motivation, it makes plenty of sense. What do you do when you've been laid off by your company or forced into early retirement, and every other company like yours is also cutting back? You can stay unemployed. You can take a job you really don't want simply to stay alive. You can leave. Or you can start a company. And in some places, this last option has been taken up with enthusiasm.

Seattle was one such place. When The Boeing Co. laid off some 50,000 aircraft workers, engineers, and managers in the early 1970s, many people who lived in the area were reluctant to move. The resulting surge in entrepreneurship created a much more diversified economy that today serves as the base of a healthy region, #40 on this year's list.

Much the same thing happened in Boston when cutbacks in defense outlays and contracts took the unemployment rate close to 11% in 1975. Today's prosperity in Massachusetts can be traced to several thousand companies that formed during that period and the years following, about 3,000 of which are now categorized as fast growth. Boston is ranked #23 this year.

Detroit had a similar experience following the 1981 to '82 automobile industry cutbacks, as companies sprang up to sell parts and services that previously had been provided in-house at General Motors, Chrysler, and Ford. Other companies ventured into the hot new field of factory automation,

Much of its growth comes from firms formed during 1970s defense cutbacks.

PHOTOGRAPHS, LEFT, EDDIE HIRONAKA/THE IMAGE BANK; RIGHT, GUIDO A. ROSSI/THE IMAGE BANK

A Business Climate Test

A quick way to measure your city's entrepreneurial culture

Whether your city is high or low on the INC. metro ranking may depend less on how the downtown real-estate market is doing at this moment or whether the dominant industry is in a slump than on the city's entrepreneurial climate. While there is no precise way to measure that climate, the following quiz should give you an approximation.

1 When the mayor of the city meets with business leaders, are there as many chief executive officers of mid-size growth companies as bankers and corporate executives?

2 Are entrepreneurs invited to join the best athletic, social, and country clubs?

3 Does the local newspaper follow the fortunes of start-ups and mid-size growth companies with the same intensity and sophistication as it does large corporations?

4 Are innovative companies able to recruit nearly all of their professional work force from the local area?

5 Is there a sizable, visible venture capital community?

6 Does the local university encourage its faculty and its students to participate in entrepreneurial spin-offs?

7 Do growth-company CEOs and venture capitalists hold even a quarter of the seats on the boards of the three largest banks?

8 Does the city's economic-development department spend more time helping local companies grow than it does chasing after branch facilities for out-of-state corporations?

9 Is there decent, affordable office and factory space available for new businesses in the central business district?

10 Can you quickly think of 10 recent spin-offs—growth companies started by entrepreneurs who have left large companies?

Score: Give your city 10 points for every yes answer, and figure 60 points as the passing grade. If your city scores above 60, congratulations. If it falls below, perhaps this test—like the Metro Report itself—suggests a new set of economic priorities for your city's business and political leaders.

spurred by hundreds of millions of dollars in contracts from the Big Three. Today, as last year, Detroit holds the #50 spot on the metro ranking.

Indeed, the response-to-adversity phenomenon can be generalized to national recessions as well as local ones. One of the great strengths of our economy—especially as compared with those of Western Europe—is the penchant for entrepreneurship as a safety valve that builds the groundwork for a speedier and more lasting recovery. Many of the seeds for the enormous growth and prosperity of the past five years were sowed during the 1981 to '82 recession, when new corporate formations hit all-time highs. Similarly, the 1976 to '80 surge was based in great measure on record-level corporate-formation rates during the difficult period between 1973 and 1975.

Restructuring of the auto industry created new opportunities for small suppliers.

This countercyclical explanation would be an easy one if it happened in every place every time. But it doesn't. While Dallas, Austin, San Antonio, and El Paso continue to rank well, entrepreneurially speaking, such oil-dependent cities as Midland, Tex., Oklahoma City, and Shreveport, La., languish near the bottom of the list. Nor has adversity spurred on Duluth, Minn., in the same way as it has helped to spur on Lincoln, Nebr., Dayton, or Des Moines. Why?

One important difference seems to be that some places have a stronger entrepreneurial culture than others. By that I mean they are relatively "open" economies that are not controlled by a small number of families or large companies. They tend to have a large university or corporate research facility that generates new ideas and new technology and attracts new people. Their banking and business environment is competitive, their social structure fluid.

In contrast, the cities without a culture of entrepreneurship tend to be in the mold of the old company towns. Newcomers are not so welcome, and growing companies that bid up wage rates are not always viewed with enthusiasm in business circles. In these places, people sitting around the dinner table tend not to think of starting a company as an option because virtually nobody they know has done it. The models for success in these cities are decidedly "corporate." Banks tend to export their capital rather than risk it locally. Newspapers rarely write about entrepreneurs, even if they succeed. Company founders are rarely asked to join the right clubs or to sit on bank boards or to chair economic-development committees set up by city government.

John Kasarda at the University of North Carolina calls cities like these "upas tree cities." The dense foliage and numerous roots of the upas tree prevent any other form of vegetation from growing under it. In the same way, upas tree cities stifle entrepreneurship by providing it little nourishment or encouragement. People inclined to start businesses tend to leave such places and take their talents where they are appreciated, and where they can find the resources they need. The accompanying "Business Climate Test" might give an indication whether your own city is such a place.

Obviously, any city can cite its list of 10 prominent entrepreneurs. But the question is whether those 10 *are* the list or simply top it—whether those entrepreneurs have succeeded because of the city's business climate, or in spite of it. A city cannot thrive on exceptions. In the long run, it will thrive only if it is a place that responds to hard times with hustle—a place in which energetic people with new ideas feel comfortable branching out on their own. □

David L. Birch is president of Cognetics Inc. and director of MIT's Program on Neighborhood and Regional Change.

METRO REPORT continues on page 84

PHOTOGRAPH: DAVID J. MAENZA/THE IMAGE BANK

METRO REPORT

CAN CHICAGO BE SAVED?

Among the nation's biggest cities, Chicago lags behind, a victim of political division, a big-company mentality, and its own past success

BY DAVID MOBERG

TO THE POET IT WAS THE "CITY OF the big shoulders," the paradigm of a thriving metropolis in the American industrial era. To the politician it was the "city that works," proud, hardworking, and so full of opportunity that blue-collar immigrants would write the folks back home, "If you can't find a job in Chicago, you can't find one anywhere."

Carl Sandburg and Richard Daley are gone now, and so, alas, is the Chicago that each helped to define. Although it is still a big and vibrant city, Chicago's manufacturing base has been eroded, its growth slowed, and its economic future is uncertain. Like the large industrial corporations on which it was built, Chicago has only slowly and reluctantly adapted itself to the entrepreneurial era that has helped to sustain or revive so many other cities.

The figures on the INC. Metro Report tell part of the story. Of the 14 biggest cities with work forces larger than a million, Chicago is able to beat out only the much-maligned Cleveland. Not only does Chicago lag behind Sunbelt boomtowns Los Angeles and Miami, and high-technology meccas Boston and San Francisco, but it also takes a backseat to such midsize Rustbelt towns as South Bend. To think of Chicago is to think of none of the new companies or industries that are helping to reshape the American economy. The new Chicago millionaires are not industrialists or retailers or high-tech wizards, but successful traders and manipulators on the commodities and financial futures exchanges.

WOUNDED GIANT

Among metro areas with more than a million workers, Chicago ranks next to the bottom of the INC. rankings

	Growth in Jobs	Business Birthrate	% High-Growth Companies	Total Score
Atlanta	36.3	4.6	4.2	69.94
Washington, D. C.	32.3	4.2	4.4	67.37
Dallas	23.5	5.3	3.9	67.19
Boston	17.5	2.8	4.6	54.90
Los Angeles	16.7	3.5	3.4	51.03
Minneapolis	15.2	2.8	4.1	50.85
Miami	18.2	3.8	2.8	49.53
San Francisco	14.1	2.8	3.9	49.16
Philadelphia	13.6	2.5	3.8	46.60
Detroit	21.8	2.6	3.2	46.51
New York	12.5	2.6	3.1	42.32
Houston	-11.1	4.2	2.8	40.64
CHICAGO	**10.2**	**2.4**	**3.1**	**40.29**
Cleveland	5.9	2.2	3.2	38.13

One reason for Chicago's lackluster employment growth has been the city's inability to spawn new companies.

Why?

In many ways, Chicago is a victim of its own past success. At the turn of the century, Chicago was the colossus among American cities. It had played a central role in developing the nation's agricultural production with its tractors and tools (International Harvester) and shared in much of the nation's agricultural wealth (Beatrice Foods). Its railroads—including Chicago & North Western and the Burlington Northern lines—pioneered the form of the modern corporation, and it was in Chicago that factories produced the steel for the tracks and the Pullman cars that rode over them. Through it all, Chicago's corporations thrived on mass production (the meat packers once clustered around the famed Chicago stockyards were the original disassembly lines), mass distribution (the Merchandise Mart of Chicago), and mass marketing (Chicago-based Sears Roebuck, Montgomery Ward, and Spiegel). Chicago's blue-collar work force turned out just about everything—from engines and machine tools to such durables as televisions, radios, telephones, and bicycles—for a growing and prosperous economy.

Trouble came late to Chicago—and was seen even later. Because of its size and diversity, Chicago was able to flourish through most of this century, even after the bottom fell out of economies in one-industry towns such as Pittsburgh and Detroit. But Chicago seemed determined not to learn from their examples. Lots of

Chicago, a city blinded by its own success

people had made lots of money, in the process creating a comfortable, conservative business culture that led managers to resist change and to ignore problems.

Once it began in the early 1980s, the pace of decline was staggering. Between 1979 and 1984, the city lost about a quarter of its manufacturing employment, 170,000 jobs—more manufacturing jobs than there were in either Philadelphia or Pittsburgh, and nearly as many as there were in Cleveland. A study by Robert Sheets found that nearly two-thirds of those losses were the result of active disinvestment by the large corporations that had dominated the region's economy. Some, like General Electric's Hotpoint unit, planned to move production to the Sunbelt, while others, like Zenith, moved much of its production offshore. Bell & Howell, the camera maker, has virtually gotten out of manufacturing.

Chicago's small-business sector was in no position to pick up the slack. For one thing, it was relatively small: the fraction of establishments employing more than 250 employees was higher in Chicago than in any of the other major industrial cities. And small companies—particularly manufacturers—found that their fortunes were closely linked to the fortunes of the region's large corporations. In Illinois as a whole—and undoubtedly in Chicago in particular—the ratio of secondary to primary manufacturing establishments was 13 to one, compared to a national average of 7 to one. As such companies as FiatAllis, in Springfield, and International Harvester, in Rock Island, either shrank or collapsed altogether, the shock waves were felt along assembly lines all over Chicago.

In short, Chicago, even more than most cities, had built its economy and its business culture around its giant manufacturers. By the early 1980s, however, it was becoming clear that it would take a new generation of companies and company builders to provide the energy and growth for Chicago's economy. But the new generation was not readily at hand.

"Historically, Chicago had a low pressure for entrepreneurship," says Jack Sheehan, an Illinois Bell executive who heads up the Friends of Small Business network. "We had big companies growing, succeeding, and creating a sufficient supply of jobs. Over a long period of history we were not stimulated, triggered, forced to create an entrepreneurial environment. I'm afraid that, as recently as five years ago, when somebody said, 'Boy, I'd like to start a business of my own,' people would say, 'Why would you ever do that?' "

As the bad economic news began to wash over Chicago's business and political establishment, the first reaction was to declare victory and claim that Chicago had made a miraculous transition to a service and financial center. Pointing to the high rises downtown, and the glitzy shops and hotels along the lakefront, Chicago boosters declared that the city of the big shoulders had become the city of well-sharpened pencils. But not only was that untrue, it was dangerously misleading. "It was," says Loyola University of Chicago professor John Ward, "a sign of resignation, not hope."

"We tend to think we can grow small-business or service-sector jobs regardless of what's going on in other sectors," observes David Allardice, a vice-president of the Federal Reserve Bank of Chicago. "But if your state's traditional strong sectors are withering, it's going to have spillover effects on small business." Although there are always interesting exceptions, Allardice says it is naïve to think that displaced steelworkers are going to run off and start new businesses in the way laid-off engineers have during high-tech shakeouts.

Indeed, the absence of a strong high-tech sector in Chicago is a curious phenomenon. A generation ago, metropolitan Chicago was a leader in consumer electronics, with Zenith, Motorola, Admiral, and Sunbeam as major employers, and even today Cook County boasts the country's fifth largest concentration of electronics companies. Chicago also ranks third among metro areas in corporate research and development. The area is home to two prestigious laboratories, Enrico Fermi Institute and Argonne National Laboratory, and there are numerous top-drawer universities. So why isn't Chicago generating new high-tech industries to replace the old?

One reason has to do with the nature of its universities. "The biggest impediment is that there's no technology-based institution of higher learning that serves the area the way MIT, Stanford, or even the University of Minnesota does," says Michael J. Birck, president of Tellabs Inc., a 1,500-employee telecommunications-equipment manufacturer started in 1975.

The University of Chicago touts its Nobel laureates, but it is not known for its hands-on involvement with the local economy. U of C has no engineering school, and its bent has been decidedly toward theoretical research ever since Enrico Fermi conducted the first controlled, self-sustaining nuclear chain reaction there in 1942. The university has continued to play a leading role in high-energy physics, and through its affiliation with the Argonne laboratory it has taken leads in low-temperature and superconductivity research, but these have generated few commercial spin-offs. Perhaps to counter that trend, the laboratory and the university recently announced the formation of a new program to promote and lease research ideas to business. Notably, however, the first contract went to a company in Tucson.

There *is* a strong engineering school at Northwestern University, in nearby Evanston, but only recently has the school tried to overcome its traditional aloofness by linking its researchers to local business through Northwestern University/Evanston Research Park, an innovation center, and a concentration on new materials research. And just three hours away in Champaign, the University of Illinois turns out more engineers than any other school in the country, but more than half of its graduates eventually leave the state.

Because of its size and diversity, trouble came late to Chicago—and was seen even later.

The attitude of its universities, however, cannot fully explain Chicago's disappointing high-tech performance. Ann Markusen, coauthor of *High Tech America* and the author of studies of regional economies, makes a convincing case that the pattern of military spending has a lot to do with it. "Defense spending per capita is a very important determinant of where high-tech growth has taken place," Markusen explains, "and defense spending has increasingly detoured the industrial heartland."

Illinois as a whole has been something of a poor relation when it comes to landing defense-procurement contracts. In 1951, Illinois, on a per-capita basis, had 90% of the national average of defense-procurement spending, dropping to 20% by 1984. By contrast, during the same period, Massachusetts went from the national average to 230% of the national average, and California from 180% to 210%. And when

PHOTOGRAPH: MARK SEGAL

Chicago, the city of corporate giants

research funds are broken out, the area looks even worse: the Great Lake states get only 14% of the national average for military R&D money, compared with 157% for New England and 175% for the Pacific Coast states.

"Chicago today is known for . . . I don't think I can pin a label on what it is known for," says Robert Pershing, president of Teltrend Inc., a Chicago high-tech firm that was #93 on last year's INC. 500 list of the fastest-growing private companies. "At one time you could say radio and television. . . . Today, it's not. Steel—we all know what happened to that industry. It's not known any more for extremely large consumer goods. It's not known for military. It's not automobiles. What is it? The drawback is that Chicago has not become known as the leader in anything. Silicon Valley is A in electronics, Detroit is A in autos, and Chicago is B and C in lots of things."

In short, the diversity that for so many years served Chicago well, and allowed it to weather the cycles of various industries, now seems to some a drawback. Especially in the fast-paced world of high tech, the common complaint is that there aren't enough like-minded people around to create a vibrant high-tech community—not just entrepreneurs and engineers, but also knowledge investors and venture capitalists and consultants who often help shepherd young companies through infancy.

"Five years ago, high tech was relatively new here," says Casey Cowell, one of the founders of U.S. Robotics Inc., an INC. 500 manufacturer of data communications equipment, "so within the Chicago business community, you were talking a different language. It takes 100 to 200 start-ups before the consultants appear and the banks get familiar and the infrastructure is created to support that."

Adds Cowell, hopefully, "I think the Chicago area has now just passed that hurdle."

Chicken-and-egg question: which come first, the venture capitalists looking to invest or the entrepreneurs looking for financing? For Chicago, this is more than idle speculation.

Although less well known than those of Boston or San Francisco, and smaller than that of New York, Chicago has a significant venture capital community. A decade ago, Chicago managers controlled 10% of the nation's venture money, while today it controls only 5%, or about $1.1 billion. Worse still, much of what Chicago venture money there is, is invested somewhere else. According to Venture Economics Inc., all of the state of Illinois attracts only 3% of the nation's venture funds. The figure for metropolitan Chicago is probably closer to 2%.

"There's been plenty of venture capital in Chicago," says Jane Morris, editor of *Venture Capital Journal,* "but typically the entrepreneurs haven't been as abundant or sophisticated." Joan Fortune, a general partner at Frontenac Co., in Chicago, agrees. She insists the problem isn't availability of money but rather derives from the absence of "role models, culture, and support systems."

As you might expect, you get a different story from the company founders, who complain that Chicago's venture capitalists are too timid, too interested in large deals, and too enamored of high tech to the exclusion of the kinds of low-tech manufacturing ventures for which Chicago is ideally suited.

As for bank financing, Chicago's major lenders have not been known for their commitment to small and midsize growth companies. As their big industrial customers began to decline, the banks found themselves at a loss in trying to make the switch to smaller customers who had new ideas and technologies but not a whole lot in the way of fixed assets. In addition, the banks have been weakened by the collapse of farm and commodity prices, troubles with Third World debt, and by a string of ill-advised oil-field loans.

"I just think banks are unimaginative," complains Robert Eustace, founder of Applied Systems Inc. Despite the fact that Applied Systems is one of the nation's leading software suppliers to casualty insurance brokers, and is #13 on last year's INC. 500, "we still have financing difficulties. I don't know if they understand the business."

To help bridge this financing gap, the Chicago Capital Fund was started in 1986 and by the end of last year had raised $7 million. Research at the time showed that venture funds had avoided deals of less than $500,000 because of high costs and low returns. Yet it was in companies of this size—50 employees or fewer—that most new jobs in Chicago were being generated, at least in manufacturing. Chicago Capital Fund aims to put out smaller investments with lower but more reliable returns than most private venture funds. But, like most other venture funds, it is focusing on second-stage financing, steering clear of start-ups. So-called seed capital is a gaping hole in Chicago's already spotty and conservative financing structure.

"There is no reliable source of start-up financing in this town," concedes Lawrence Rosser, president of Chicago Capital Fund. "Other cities have done a better job."

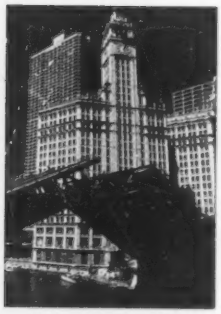
Like most cities, Chicago is a study in contrasts. Only a few miles from the wastelands of Chicago's South Side rise the glass and steel towers of the Loop, which has seen $10 billion in construction completed or committed since 1979. Along the West Side, you can drive by desolate stretches of decayed housing and industrial facilities that look like Dresden after the fire storm. But there is nothing short of a little high-tech boomlet in the comfortable western and northern suburbs of Du Page and Lake Counties, where software, telecommunications, and pharmaceutical companies have begun to cluster.

In Chicago, these are more than mere contrasts. In reality, they are the manifestations of deep divisions—divisions that, until recently, have made it hard for the different Chicagos to admit to their declining economic circumstance and join together to meet the challenge head-on.

Chicago's universities have shied away from hands-on involvement with the local economy.

Partly that is a political failing, one that must be laid at the feet of the man who defined Chicago politics for more than a generation, Mayor Richard J. Daley. Although Daley proclaimed his the "city that works" and took special pride in the fact that he lived in a working-class neighborhood, his tenure was marked by nothing more than the abandonment of working-class Chicago. Daley's preoccupation was with the highway, the urban-renewal bulldozer, and the skyscraper, and his focus was single-mindedly on the downtown Loop. Undoubtedly, some of that attention was justifiable, but it often proceeded from cynical motives. The downtown building boom provided jobs for the conservative building trade unions that were strong supporters of the Daley machine. It offered a grab bag of graft and windfall profits for the speculators, aldermen, and machine insiders who milked the deals for every penny. And it gave Daley's patronage-burdened city government an

PHOTOGRAPH: STOCKPHOTOS/CHARLES VARON



Chicago, a city often divided against itself

expanding base of property tax revenues. For Daley, revenue was more important than economic growth, and patronage jobs—public or private—were the only ones that counted. It is a commentary on his priorities that the city didn't have an economic-development office until just before his death in 1976.

Other politicial institutions failed the city. The age-old antagonism between the Democratic machine in Chicago and a succession of Republican governors in Springfield was for many years a barrier to effective state economic-development initiatives. And in Congress, the partisan divisions back home reflected themselves in an Illinois delegation that, although large, lacked the cohesion necessary for winning key grants and contracts. According to a report of the big-business-dominated Commercial Club of Chicago, Illinois suffered the loss of $32 billion in federal spending between 1983 and 1985, just about the amount gained during the same period by the state of California.

For different reasons, the business community was late in responding to the deterioration of Chicago's economic base. Pride can explain some of it. But also at work was an ideological bias with its roots in the economic theories of the so-called Chicago School.

"Milton Friedman [and his colleagues at the University of Chicago] had an enormous influence here," argues George Kalidonis, a former Procter & Gamble executive who now heads the Chicagoland Enterprise Center. "Many business leaders were his students or picked up his extreme free-market view of business life." In economic-development circles, the buzzwords today are "public-private partnerships." In Chicago, the very notion of such partnerships was anathema to business leaders who saw their only responsibility as serving the immediate interests of stockholders rather than the long-term interests of the Chicago-area economy.

Race is also a factor. As an Illinois politician of the last century might have put it, a city divided against itself cannot prosper. And until recently Chicago has been one of the most racially divided and segregated of the big American cities.

Chicago blacks, who now account for 40% of the population of the city proper, have taken the brunt of the city's economic decline. In the 1950s and '60s, the city's industrial plants had offered poor blacks moving up from the South an opportunity for decent jobs and a chance to move, however modestly, into the city's middle class. When those factories closed, it was black workers who were hit disproportionately, and it was laid-off black workers who had the hardest time finding other work.

Nor were there many other avenues for black advancement. Despite the presence of some of the largest black-owned businesses in the country, such as Soft Sheen Products Inc. and the publisher of *Jet* and *Ebony* magazines, black entrepreneurship was very limited, a result of discrimination and the lack of an entrepreneurial tradition. Jesse Jackson's Operation PUSH had successfully fought for black franchises from big chains, and Elijah Muhammad's Nation of Islam had once encouraged blacks to start their own businesses. But overall, both have had minimal impact.

In 1983, there were two events that began to break the back of the old system and hinted at a new Chicago, one more united and determined to address its economic future. The first was the upset election of Harold Washington as the city's first black mayor. Washington's campaign pledged reform of the corrupt city government, and promised a new emphasis on balancing investment in downtown buildings with investment in jobs and housing in neglected neighborhoods. Among Washington's initiatives was a controversial proposal to prevent many of the city's industrial buildings from being turned into high-priced housing. The new mayor also supported a "buy Chicago" plan that pledged city government to purchase more of its goods and services from small Chicago companies and enticed a number of major businesses to do the same. Picking up on Daley's old motto, Washington vowed to make Chicago the "city that works together."

The Commercial Club formed its Civic Committee as a result of research into the Chicago economy, which led to a 1984 report, *Make No Little Plans: Jobs for Metropolitan Chicago*. The title adopted the watchword of the famed city planner and architect Daniel Burnham, whose turn-of-the-century thinking heavily influenced the development of Chicago. The report recommended a variety of cooperative public and private supports for growing businesses, and, according to George Kalidonis, represented the "symbolic break with the Milton Friedman mind-set."

Other cooperative efforts were taking shape, led by social entrepreneurs unafraid to take risks where business was reluctant, bucking the presumed wisdom of the marketplace. The Community Workshop on Economic Development has launched "community enterprises" to help poor Chicagoans create jobs in their own neighborhoods. Affiliates of CANDO, the Chicago Association of Neighborhood Development Organizations, help small businesses find space, financing, and markets, and work together to fight crime. The Center for Neighborhood Technology helps small manufacturers, either singly or cooperatively, to solve toxic-waste problems and cut energy use. The Industrial Council of Northwest Chicago has launched several successful incubators. These and many more such efforts now make Chicago the richest center for neighborhood-level economic-development efforts in the country, according to Alan Okagaki, project director of the Corporation for Enterprise Development, in Washington, D.C.

At the same time, Chicago manufacturers are realizing that they must cooperate to survive, and task forces have begun developing strategies for the apparel, steel, and printing industries. With some public funding, a business incubator was established next to a medical center and the University of Illinois at Chicago, and has spawned a few biomedical research firms. And under consideration are joint ventures and joint ownership of expensive scientific equipment. These are modest steps toward a more cooperative economic environment. But in Chicago, they represent something of a sea change.

Despite his working-class ethos, Daley's tenure was marked by the abandonment of Chicago industry.

"One of the great strengths of the people in the Midwest is their rugged individualism," says Jack Bishop, director of the Technology Innovation Center at Northwestern University, "and one of the great weaknesses of the people in the Midwest is their rugged individualism." Bishop says that most other cities long ago realized that cooperative support structures would generate economic growth. "We're just starting to develop that in Chicago," he says. □

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PHOTOGRAPH: STOCKPHOTOS/CHARLES VARON